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No. 85-762

In The

Supreme Court of the United States

October Term, 1985

Thelma T. Metge, Executrix of the Estate of August Metge, and Elizabeth G. Shepard on behalf of themselves and on behalf of all others similarly situated,

Cross-Petitioners,

vs.

Bankers Trust Company,

Cross-Respondent.

On Cross-Petition For A Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit (Cross-Petition to No. 85-555, October Term, 1985)

CROSS-PETITIONERS' REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

W. Don Brittin, Jr.
Gerald J. Newbrough
Kasey W. Kincaid
Nyemaster, Goode, McLaughlin, Emery & O'Brien
Tenth Floor - Hubbell Building
Des Moines, Iowa 50309
(515) 283-3100

Attorneys for Cross-Petitioners

COCKLE LAW BRIEF PRINTING CO., (800) 835-7427 Ext. 333

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The Brief in Opposition filed by Bankers Trust Company (BTC) contains several inaccuracies concerning the contentions and evidence presented in this case. At least some of these statements must be corrected if the Court is to have a proper understanding of the issue presented in the Cross-Petition.

At issue in this Cross-Petition is the proper standard for determining whether a secondary defendant had control over a primary defendant under section 20(a) of the Securities Exchange Act. By adopting a standard that requires proof of the secondary defendant's actual *exercise* of control over the *general operations* of the primary defendant, the Court of Appeals places itself in direct conflict with numerous judicial decisions, as well as the SEC definition of "control", which provide that the *power to control* the affairs of the primary defendant is sufficient to establish a prima facie case of control. Whether a secondary defendant must be a "culpable participant" in the underlying violation is not at issue here; both the District Court and Court of Appeals correctly concluded that culpable participation is not a prerequisite to control, and the propriety of that decision has not been challenged in this Court.

In demonstrating the existence of BTC's power to control the affairs of IEI[1], the primary violator, Plaintiffs rely upon complicated and voluminous facts, circumstantial evidence and permissible inferences. These facts are set forth in Plaintiff's Brief in Opposition (adopted by reference in Plaintiff's Cross-Petition) and, contrary to BTC's assertion, are fully supported by the record: Plaintiffs filed an appendix in excess of 2400 pages with the Court of Appeals and documented their lower court briefs with a multitude of references to the record. BTC makes several misstatements concerning these facts.

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[1]Plaintiffs use the same names and terms of art in this Reply as in their prior filings in this case.

BTC contends that Plaintiffs hinge section 20(a) control on so-called "boiler-plate" loan agreement provisions. This claim is inaccurate. First, some of the loan agreement provisions were, by BTC's admission, more bizarre than boiler-plate, *e.g.*, loan agreement provisions relating to the MIL Proxy, the "put", the public-offering covenant and the IEI Stock. Second, Plaintiffs do not contend that typical loan agreement provisions, such as borrowing restrictions, are *per se* determinative of control. Nor should they be. They are, however, part of the total circumstance of control and are at least probative of control. This is especially true when their purpose is atypical, such as with the loan restrictions added by BTC to prevent IEI, a borrower in dire need of operating capital, from securing additional financing unless BTC received the proceeds. Boiler-plate loan provisions can be very powerful when the borrower's existence and the lender's hopes for repayment are dependent on them, especially when the lender believes that a borrower's primary lender "can assert any kind of pressure" it wishes.

BTC also asserts that "Plaintiffs *rely primarily* upon events which occurred several months after the sale of Thrift Certificates ceased on May 10, 1974 [to establish control]." (BTC Brief in Opposition, p. 3.) This assertion is erroneous. Plaintiffs acknowledge, and have always acknowledged, that section 20(a) liability is predicated on the power to control *during the period of the primary violations*. The record is replete with documents and events existing and occurring while the Thrift Certificates were being sold which combine to establish control. (See Statement of Facts at pages 6-18 of Plaintiffs' Brief in Opposition, incorporated in Plaintiffs' Cross-Petition for Writ

of Certiorari.) Plaintiffs have also always urged the relevance of certain matters existing and occurring before and after the sale of the Thrift Certificates as *probative* of BTC's control *during the period of the Thrift Certificate sales.* (See Statement of Facts at pages 2-5 & 18-19 of Plaintiffs' Brief in Opposition, incorporated in Plaintiffs' Cross-Petition for Writ of Certiorari.) For instance, BTC's knowledge and its active exercise of control just before and just after IEI's 3½-year securities fraud emanate from the same or related borrowers, loans, documents, collateral and lender-borrower relationships as those existing at the time of the securities fraud, and are therefore certainly probative of BTC's power, knowledge, motives, abilities, inclinations, character and scienter during the intervening securities fraud. In other words, Plaintiffs do not rely primarily on events occurring before and after the sale of Thrift Certificates to establish section 20(a) control; rather, pre- and post-violation events and documents are only offered because they are probative of BTC's control during the period of the securities fraud.

BTC tells this Court that "[*all*] of IEI's officers and directors *testified in detail* that [BTC] did not concern itself with the day-to-day operations of [IEI] and was not in control either of the Thrift Certificate program or [IEI] itself." (BTC's Brief in Opposition, p. 3.) This is similar to what BTC told the Eighth Circuit, that is "[*E*]*veryone* of the Defendants, the directors and officers of IEI *positively stated* that BTC had no knowledge whatsoever of the Thrift Certificate program and did not participate in it in any way." Contrary to these statements, the record discloses a very constant, intimate and symbiotic relationship between BTC and IEI. Also, BTC

takes unfair liberties with the testimony of IEI's officers and directors regarding the Thrift Certificate program. During depositions these people were asked by BTC's counsel if they *knew of any facts* to support *allegations* that BTC was an *"initiating force" behind the sale of Thrift Certificates*, that BTC had participated in "the *promotion of the sale" of Thrift Certificates* or that BTC had attended meetings "where the *major discussion revolved around the sale" of Thrift Certificates*. Each officer/director answered "no", that is, that he had no knowledge of any facts regarding those very specific allegations—allegations which have never been made by Plaintiffs and which are not necessary to Plaintiffs' section 20(a) claim. This testimony is qualitatively quite different than BTC claims it to be.

BTC argues that because it was only a pledgee of the IEI Stock, as opposed to an owner, it could not be a controlling person of IEI. (BTC's Brief in Opposition, p. 6.) This hypothesis conveniently ignores the numerous other indicia of control. It also conflicts with the district court's finding "that legal title to the [IEI Stock] passed to BTC's nominee, giving BTC the power to vote 17-18% of the common stock of IEI," 577 F. Supp. 810, 813, a finding shared by the Court of Appeals. 762 F.2d 621, 626. It also promotes form over substance when the real and ultimate issue is the power to control occasioned by the IEI Stock. Finally, BTC misinterprets the Bankruptcy Judge's ruling in IEI's bankruptcy proceeding. The issue before the bankruptcy court was whether the "put" (IEI's obligation to pay a specific sum for the then worthless IEI Stock) was a provable claim entitled to share in the general assets of the bankruptcy estate. The issue was not whether

BTC owned the IEI Stock or whether the IEI Stock was collateral for BTC loans. The Bankruptcy Judge merely ruled that the "put" was a provable claim. He *did not* rule that BTC was not the owner of the IEI Stock. He would have known that an underlying premise of every put obligation is that the optionee (BTC) has title to the underlying securities (IEI stock) so it can pass title to the optionor (IEI) if the put is exercised.

These facts, taken together with the voluminous additional record evidence, were sufficient to generate a genuine issue of material fact concerning BTC's control over IEI. By focusing only on proof of the actual exercise of control over IEI's general corporate operations, however, the District Court and Court of Appeals have adopted an unjustifiably restrictive standard that requires courts to ignore the numerous other indicia of control which may be present in a given case.

In contending that this restrictive standard is correct, BTC relies upon *Sanders v. John Nuveen & Co.*, 524 F.2d 1064 (7th Cir. 1975), *vacated and remanded*, 425 U.S. 929 (1976). This reliance is misplaced. In *Sanders*, the primary defendant, Nuveen, acted as the underwriter for securities sold in violation of Rule 10b-5 and was held to be primarily liable under Rule 10b-5 for its own misrepresentations and its failure to properly perform its underwriting duties. The district court also held that three other corporations controlled Nuveen and were secondarily liable to the plaintiffs as controlling persons under section 20(a). As to defendant Investors Syndicate of America, which owned 100% of the voting stock of Nuveen, and the more remote Investor Diversified Services, which owned 100% of the voting stock of Investors Syndicate

of America, the Court of Appeals affirmed the district court's finding of secondary liability. As to the very remote Alleghany Corporation, however, which owned 40% of the voting stock of Investors Diversified Services, the Court of Appeals reversed. Control of Nuveen was assumed by the Court of Appeals all the way up the corporate family tree, but Alleghany was exonerated because it "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation". Alleghany's lack of participation in the management of Nuveen did not mean it did not have control over Nuveen; rather, this lack of participation became significant with respect to the statutory defense of good faith and non-inducement. In other words, Alleghany was a controlling person even though it only owned 40% of the 100% owner of the 100% parent of Nuveen, but was exonerated after a trial on the merits because it met its statutory affirmative defense of good faith and non-inducement.

Thus, *Sanders* is consistent with Plaintiffs' position and the weight of authority. Actual exercise of control over the general operations of the primary violator is not a condition precedent to a finding of control. While it may be a factor in determining the presence of control, and while it will of course be of significance in connection with the affirmative defense of good faith and non-inducement, actual exercise of control over general operations is not, and should not be, a prerequisite to a finding of control.

BTC also misinterprets Plaintiffs' statement that "[p]revious decisions involving lender liability under section 20(a) have not found it necessary to modify accepted standards and definitions to protect lenders." (Cross-

Petition at p. 11.) This statement is completely accurate and does not carry with it any suggestion that any other lender has been held liable under section 20(a). BTC's conduct and relationship with its borrower is far different than actions of lenders in other cases. The point is that a special rule of control for lenders, such as that imposed by the lower courts in this case, is not needed and was not authorized by Congress.

This litigation has been pending since 1979. The Court of Appeals correctly concluded that Plaintiffs have generated genuine factual issues concerning BTC's liability as an aider and abettor, and Plaintiffs are anxious to proceed to trial on this claim. Should this Court grant BTC's petition for certiorari on aiding and abetting liability, however, Plaintiffs believe plenary consideration must also be given to the conflicts created by the Court of Appeals' unduly restrictive standard of control under section 20(a).

Respectfully submitted,

W. Don Brittin, Jr.
Gerald J. Newbrough
Kasey W. Kincaid
Nyemaster, Goode, McLaughlin,
Emery & O'Brien
Tenth Floor - Hubbell Building
Des Moines, Iowa 50309
(515) 283-3100

Attorneys for Cross-Petitioners